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IN THE

Supreme Court of the United States

OCTOBER TERM, 1965

No. ~~1109~~ 247

COLUMBUS AND GREENVILLE RAILWAY COMPANY,
Petitioner,

versus

COMMISSIONER OF INTERNAL REVENUE, *Respondent.*

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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Petitioner prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Fifth Circuit entered March 24, 1966.

OPINION BELOW

The opinion of the Tax Court (R. 35-67) is reported at 42 T.C. 834. The opinion of the Court of Appeals (Appendix A, infra, p. 1a) is reported at 358 F. 2d 294.

JURISDICTION

The judgment of the Court of Appeals was entered on March 24, 1966. (Appendix B, p.) The jurisdiction of this Court is invoked under 28 U.S.C. section 1254.

QUESTION PRESENTED

Is a purchaser of property entitled to include in its cost-basis for computing deductions for depreciation the amount of the mortgage to which the property was subject at the time it was purchased?

STATUTES INVOLVED

Internal Revenue Code of 1939

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * *

(1) DEPRECIATION.—A reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence)—

(1) of property used in the trade or business, or
(2) of property held for the production of income.

* * * * *

(n) BASIS FOR DEPRECIATION AND DEPLETION.—The basis upon which depletion, exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be as provided in section 114.

SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

(a) BASIS (UNADJUSTED) OF PROPERTY. The basis of property shall be the cost of such property;

(b) ADJUSTED BASIS. The adjusted basis for determining the gain or loss from the sale or other disposition of property, whenever acquired, shall be the basis determined under subsection (a), adjusted as hereinafter provided.

SEC. 114. BASIS FOR DEPRECIATION AND DEPLETION.

(a) BASIS FOR DEPRECIATION.—The basis upon which exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be the adjusted basis provided in section 113(b) for the purpose of determining the gain upon the sale or other disposition of such property.

STATEMENT

The pertinent facts may be summarized as follows:

The Georgia Pacific Railway Co. was organized November 10, 1881, for the purpose of constructing a railroad line from Atlanta, Georgia, to the Mississippi River. In order to complete construction of this line of railroad, Georgia Pacific executed a general first mortgage to the Central Trust Company of New York, as Trustee, under which mortgage there were issued and delivered $5,660,000 bonds. This first mortgage was dated May 6, 1882. (R. 38)

In 1888, Georgia Pacific issued bonds which were secured by a second mortgage on the Georgia Pacific property. (R. 39)

The railroad line from Atlanta to the Mississippi River was completed in 1888 and Georgia Pacific operated the line until July 17, 1893, when it met with financial reverses and was placed in receivership. (R. 38)

On August 21, 1894, the entire property of the Georgia Pacific was sold upon foreclosure of the second mortgage. Southern Railway Company, which had been incorporated in Virginia to take over the properties of a defunct Virginia railroad and other defunct railroad properties, or persons acting for it, bought all the properties of the Georgia Pacific at the foreclosure sale. (R. 39-40)

The railroad properties of Georgia Pacific located in Alabama and Georgia were transferred to Southern Railway Company which operated the lines in Alabama and Georgia. Because of Mississippi law, a Mississippi corporation known as Southern Railway Company in Mississippi, was formed as a wholly owned subsidiary of Southern, and the property formerly owned by Georgia Pacific in Mississippi was transferred to Southern Railway Company in Mississippi which operated the lines in Mississippi. (R. 40-41, 57-58)

All of the Georgia Pacific properties acquired by both Southern Railway Company and Southern in Mississippi were acquired subject to the Georgia Pacific first mortgage of 1882. The properties of both railroads were covered by the entire Georgia Pacific mortgage. (R. 41, 58)

At or about the same time, Southern acquired numerous other railroad properties and in 1894 mortgaged all of the properties owned by it to secure $120,000,000 in face value of first mortgage bonds issued, or to be issued, by Southern for operating expenses, completion of railroad beds, retirement of prior lien mortgages when they became due, and for other purposes. Southern in Mississippi was not a party to this mort-

gage, and neither its properties nor its stock were pledged under the mortgage. (R. 58)

Under the terms of its charter and the mortgage of 1894, mentioned above, Southern expressly recognized that Georgia Pacific's first mortgage of 1882 constituted a lien prior and superior to that created by its 1894 mortgage. (R. 40, 58)

In 1921 Southern in Mississippi, whose name had been changed to Columbus & Greenville Railroad Co., was in financial difficulties and its properties were placed in receivership and operated by a receiver until 1923. In 1923 the properties of the Mississippi corporation, that is, Columbus & Greenville Railroad Co., were sold at public sale to persons buying them for the petitioner. The petitioner was formed in 1923 to take over these properties. The properties were transferred to petitioner for $35,000 in cash and subject to the Georgia Pacific mortgage of 1882 and subject to the $200,000 mortgage of the predecessor Mississippi corporation. (R. 47-48, 58-59)

In 1921 Southern issued a sufficient amount of its first mortgage bonds under its mortgage of 1894 to acquire and redeem all of the Georgia Pacific bonds then outstanding. The funds for this purpose were deposited with the trustee which acquired all but $1,000 of the Georgia Pacific bonds by the end of 1923. The Georgia Pacific bonds were not immediately cancelled but were held alive by the trustee as additional collateral security under Southern's first mortgage of 1894 until 1926. (R. 59)

In February 1926, the petitioner began negotiations with Southern regarding how much, if any, of the Georgia Pacific mortgage indebtedness petitioner

should assume, and how and when the same should be paid. These negotiations resulted in an agreement between petitioner and Southern in 1926, whereby petitioner was relieved of all obligations under the Georgia Pacific mortgage in consideration for agreeing that if Southern should ever take over petitioner's properties that the price shall not exceed the amount which the present owners have put into the property, plus the value of any additions and betterments that may be added, and other considerations. Southern also agreed to cancel the lien of the mortgage and its satisfaction of record. (R. 48-50)

After the agreement between Southern and the petitioner, the trustee on May 3, 1926, destroyed the bonds and issued a release and satisfaction of the Georgia Pacific mortgage to both Southern and the petitioner. (R. 50-51)

Petitioner, with permission of the Interstate Commerce Commission, made entries in its books in 1928 charging $2,038,335.80, which it computed on a mileage basis to be its share of the liability under the Georgia Pacific mortgage of 1882, to cost of its railroad properties and crediting a like amount to surplus. (R. 51-56)

Petitioner did not report the $2,038,335.80 as income for Federal tax purposes in 1928 or any other year. (R. 56)

Petitioner included the amount of $2,038,335.80 allocable portion of the Georgia Pacific first mortgage of 1882 as a part of its cost basis in computing its depreciation deductions by the retirement method. (R. 57) The Commissioner of Internal Revenue and the Tax Court have held that the petitioner is not entitled to

include this amount in its basis for computing depreciation deductions by the retirement method for the years 1951, 1952 and 1953. The Court below affirmed the decision of the Tax Court by a per curiam opinion.

REASONS FOR GRANTING THE WRIT

1. The decision below, which merely affirmed the Tax Court's opinion in holding that the cost of property to the petitioner did not include the amount of the mortgage to which the property was subject at the time of purchase, is in conflict with the decision of this Court in *Crane* v. *Commissioner* (1947), 331 U.S. 1. In *Crane* a taxpayer, by devise from her husband in 1932, acquired an apartment house subject to a mortgage of $255,000. For estate tax purposes the property was given a valuation exactly equal to the mortgage. In 1938, the taxpayer sold the property subject to the mortgage for a net consideration of $2,500 which she reported at capital gains rates. The Commissioner contended that the unadjusted basis of the property she acquired from her husband included the amount of the mortgage and also that the amount realized on the sale included the amount of the mortgage, as well as the $2,500 net cash receipts. This Court, in sustaining the Commissioner said:

> "* * * we think that a mortgagor, not personally liable on the debt, who sells the property subject to the mortgage and for additional consideration, realizes a benefit in the amount of the mortgage as well as the boot. If a purchaser pays boot, it is immaterial as to our problem whether the mortgagor is also to receive money from the purchaser to discharge the mortgage prior to sale, or whether he is merely to transfer subject to the mortgage—it may make a difference to the purchaser and to the mortgagee, but not to the mortgagor. Or put

it another way, we are no more concerned with whether the mortgagor is, strictly speaking, a debtor on the mortgage, than we are with whether the benefit to him is, strictly speaking, a receipt of money or property. We are rather concerned with the reality that an owner of property, mortgaged at a figure less than that at which the property will sell, must and will treat the conditions of the mortgage exactly as if they were his personal obligations. If he transfers subject to the mortgage, the benefit to him is as real and substantial as if the mortgage were discharged, or as if a personal debt in an equal amount had been assumed by another." (p. 14)

When petitioner in the case at bar acquired the railroad property from the receivership in 1923, it acquired the property subject to the Georgia Pacific mortgage of 1882. The bonds under this mortgage were held alive and were a lien upon petitioner's railroad property until they were cremated on May 3, 1926, and a release and quitclaim deed was executed by the Trustee to Southern Railway Company and petitioner releasing said railroads from any liability existing under the Georgia Pacific mortgage. The Tax Court misconstrued and misconceived the holding of this Court in the *Crane* case when it repeatedly referred to the fact that the petitioner did not assume nor was it personally liable for the indebtedness secured by the Georgia Pacific mortgage. The Tax Court's opinion states: (R. 60-61)

"* * * In the present case there is no claim that petitioner assumed or was personally liable for the indebtedness secured by the Georgia Pacific mortgage. Petitioner must rely for its stepped-up basis on the theory that its basis includes some amount of the obligations secured by a mortgage subject to which it acquired the property without assuming personal liability therefor. The cases relied

upon by petitioner do not bridge the gap between the basis of property acquired only subject to a mortgage as opposed to the situation where the purchaser assumes the obligations under the mortgage.

Petitioner's principal theory finds some support in *Crane* v. *Commissioner*, 331 U.S. 1 (1947), which held that the basis of property inherited is the value of the property at date of death undiminished by mortgages on the property. The basis there involved started with value, not cost as in the case of a purchase. Whether the theory of the *Crane* case means that in a 'purchase' situation the cost of the property acquired includes the liens thereon, even though not personally assumed by the purchaser, compare *Blackstone Theatre Co.*, 12 T.C. 801 (1949), with *Fortee Properties, Inc.*, 19 T.C. 99 (1952), revd. 211 F. 2d 915 (C.A. 2, 1954), certiorari denied 348 U.S. 826 (1954), we need not decide here, because we do not think the theory of the *Crane* case is applicable here in any event."

Mertens, Law of Federal Income Taxation, Vol. 3A, § 21.11, discusses and points out that under the *Crane* case the amount of the mortgage is included in the cost basis whether the mortgage is assumed or the property is taken subject to the mortgage.[1]

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[1] It is interesting that as a result of the Tax Court's decision in the case at bar, *Mertens, Law of Federal Income Taxation*, 1965 Cum. Supp. Vol. 3A, pp. 9-10, added new material as follows (without footnotes):

"* * * Without deciding whether the theory of the Crane case means that in a 'purchase' situation the cost of the property acquired includes the liens thereon, even though not personally assumed by the purchaser, the Tax Court has held that a taxpayer may not include in its basis for computing depreciation its actual cost of property plus the balance due on the mortgage on the property at the time acquired when it did not assume the mortgage, but simply acquired the property subject to the mortgage."

2. The problem is of subtsantial and continuing importance to both the taxpayers and the Government. The Court of Appeals stated:

> "The Tax Court found 'the cost of the property to petitioner and petitioner's outlay for the property did not include any part of the $2,038,335.80 here in controversy.'"

This statement is not contained in the findings of fact of the Tax Court. The statement is one of the conclusions contained in the Tax Court's opinion. (R. 61)[2] In the Courts below, the taxpayer relied upon the cases of *Amphitrite Corporation*, 16 T.C. 1140; *Edward W. Edwards*, 19 T.C. 275; *Marion A. Blake*, 8 T.C. 546, and *Blackstone Theatre Co.*, 12 T.C. 801. The teaching of these cases is that if the obligation existed and was a part of the cost of the property at the time the petitioner obtained title to it, the fact that the obligation was extinguished, became unenforceable or settled for a lesser amount, did not affect the cost basis. The case at bar is indistinguishable from the rationale of these cases. In 1928 the Interstate Commerce Commission was familiar with the entire transportation picture, was close in time to the transaction in question, and was

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[2] The rule was pointed out in *Stone* v. *United States* (1896), 164 U.S. 380, where it was said: "We are not at liberty to refer to the opinion for the purpose of eking out, controlling, or modifying the scope of the findings." (p. 383) See also: *M. E. Blatt Co.* v. *United States* (1938), 305 U.S. 267, 276-7; *United States* v. *Shoshone Tribe* (1938), 304 U.S. 111, 115; *United States* v. *Esnault-Pelterie* (1936), 299 U.S. 201, 206; *Brothers* v. *United States* (1919), 250 U.S. 88, 93; *Crocker* v. *United States* (1916), 240 U.S. 74, 78; *Ohlinger* v. *United States* (CA-9, 1955), 219 F. 2d 310, 311.

able to resolve doubt as to any aspect of it, if such had existed, with a wealth of expert testimony then available. From this vantage point the Commission permitted the bookkeeping entry of the cost of the property that included $2,038,335.80, the petitioner's allocable portion of the Georgia Pacific Mortgage of 1882. That the mortgage was a lien and not a contingent liability was established when the property was sold to the petitioner and was fully reflected in the provisions of the petitioner's subsequent negotiations with Southern Railway Company. The petitioner has made vital decisions as to maintenance and improvements, using the basis for depreciation supported by legal authority and sanctioned by governmental agencies for more than twenty years. To reject this long established principle of cost determination and depreciation practice, and to impale the petitioner on the narrow construction of the cost of its property that excludes the mortgage to which it was subject at the time of purchase, would result in grave injustice in this case and in endless confusion, litigation and law revision. So unrealistic a concept of the cost of 181 miles of railroad, in conflict with the record of the sale, the judgment of earlier governmental agencies, and the authorities cited, is confiscatory as to the petitioner and violative of its rights under the Fifth Amendment. The decision of the Courts below in effect holds that the method by which a mortgage is satisfied determines whether the mortgage is includable as a part of the cost of the property. This result can only mean uncertainty and litigation to both taxpayers and the Government because the adjusted basis to property could be constantly changing.

CONCLUSION

For the reasons stated, the petition for a writ of certiorari should be granted.

Respectfully submitted,

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